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Acceptance Primer



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Banking Corporation
"America's Pioneer Discount Bank"
35 Wall Street New York

Acceptance Primer

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35 Wall Street, New York

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Foreign Trade Banking Corporation
New York

NO. 1651
AMERICAN BANK

L.C.-

"By enlarging the field for the sale of such paper there will be promoted the establishment of a general discount market which is universally recognized as an important element in the improvement of American banking conditions."

*Governor Harding,
Of the Federal Reserve Board.*

This booklet aims to bring together some of the more salient facts bearing on the use of Acceptances.

The numerous inquiries received by this Bank indicate a demand for elementary information. This brief summary seeks to answer this demand, to describe in simple terms what the Acceptance is, how it is used, and what recommends its use as the ideal credit instrument.

In supplying this information, the Foreign Trade Banking Corporation hopes it may contribute to the growing recognition of the advantages of the Acceptance.

Such recognition is certain, among other things, to have as a result the strengthening of the country's financial and economic condition—its ability to adjust itself to the strain of war and to meet its competitors in the "war after the war."

“The Acceptance is the standard form of paper in the world discount market and both on this account and because of its acknowledged liquidity earns a preferential rate.”

Federal Reserve Board

What the Acceptance Is

The Acceptance has been defined as a draft or bill of exchange, payable at a fixed or determinable future time, the obligation to pay which has been acknowledged in writing on the face of the bill by the person to whom it is addressed.

It is a readily negotiable certificate of indebtedness which is to be liquidated at a definite future date.

It is two-name paper, the acceptor being primarily liable.

It is essentially self-liquidating. In its chief applications, it utilizes goods as the basis of credit. Based on the sale of merchandise which in turn will be sold, it provides automatically the funds with which to pay the obligation at maturity.

Federal Reserve Definitions

The present status of the Acceptance in the United States is largely determined by the Federal Reserve Act, as amended.

FOREIGN TRADE BANKING CORPORATION

In the regulations setting forth the conditions under which Member Banks of the Federal Reserve system are permitted to accept drafts, rediscount, or purchase Acceptances, are laid down the principles chiefly governing employment.

Two kinds of Acceptances are in use—the *Trade Acceptance* and the *Bank Acceptance*.

The regulations of the Reserve Act define these terms as applied for the purposes of the Act.

The Trade Acceptance.

The Trade Acceptance is defined* as a special form of the bill of exchange, namely:

“A bill of exchange, drawn by the seller on the purchaser of goods sold, and accepted by such purchaser.”

A “bill of exchange” as used in this definition is described as “an unconditional order in writing addressed by one person to another, other than a banker, signed by the person giving it, requiring the person to whom it is addressed to pay, in the United States, at a fixed or determinable future time, a sum certain in dollars to the order of a specified person.”

The Bank Acceptance.

The Bank Acceptance is defined* as a bill of exchange, of which the acceptor is a bank or trust

*Regulation B, series of 1917.

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company, or firm, person, company or corporation engaged in the business of granting bankers' acceptance credits.

How the Trade Acceptance is Used

The business practice involved in the use of the Trade Acceptance is simple. The following example is typical:

1. A, the seller of the goods, consummates a bargain with the buyer, B. The amount due is agreed upon, with a definite term for payment.
2. A draws a bill upon B, covering the amount of money due and definitely indicating the date of maturity.
3. B, provided he is satisfied that the conditions of the sale have been complied with, accepts the bill by writing or stamping across its face "Accepted," the date and place of payment, and his name, and returns it to the seller.
4. A may hold the Acceptance until maturity, and then submit it to B for payment.
5. Or, A may discount the Acceptance and it may find several purchasers* before presentation for payment at maturity to B.
6. B pays at maturity.

*It is in the interest of maintaining the character of the Acceptance in its role as a negotiable credit medium, for the protection of its purchasers, that the requirements of "eligibility" are prescribed under the Federal Reserve Act. See page 10.

The Trade Acceptance Distinguished from the Note or Sight Draft

The Trade Acceptance is free from objectionable associations sometimes attached to the promissory note or sight draft.

It shows on its face that it is given for a purchase and not for a loan; nor does it cover a past-due account.

It is confined to credit obligations arising from the sale of goods, and it has a definite maturity fixed as an element of a current transaction.

In a financial statement, "Acceptances Payable" are an indication that the firm's business is so ordered as to enable it to pay its accounts when due.

How the Bankers' Acceptance is Used

The Bankers' Acceptance enables the drawer of a bill to obtain use of a bank's credit.

The buyer of merchandise, for instance, arranges with a bank to "accept" the drafts of the seller from whom he buys. An export transaction, a class in which these Acceptances are largely used, will illustrate the procedure in one of its forms, of which there are many:

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A "Documentary Bill"

The foreign buyer arranges an "acceptance credit" by means of a letter of credit from his own bank to an American bank. This authorizes acceptance by the American bank of drafts, under specified conditions, drawn on the bank by the American exporter, with documents attached.

The bank accepts the drafts when presented, takes possession of the documents, and forwards them to the foreign buyer's bank.

The Acceptance may now be discounted for the exporter, who thus receives cash for the goods he has shipped, and the Acceptance, as a negotiable instrument, may pass through the hands of several purchasers, to be finally presented at maturity by its holder to the accepting bank.

This bank will be reimbursed through the foreign bank by the buyer, who, in the meantime, has had a credit for the period elapsing to the bill's maturity and has had an opportunity to receive the goods.

Such an Acceptance, as evidence of eligibility, usually has stamped across its face:

"This acceptance grows out of a transaction involving the importation or exportation of goods."

A Liquid Investment

The Bank Acceptance is one of the most liquid forms of investment.

Essentially self-liquidating, it is usually of short maturity, the majority of these instruments maturing in ninety days or less.

It is certain to be paid, banking institutions being of assured standing.

What are "Eligible Acceptances"?

Acceptances are referred to as "eligible" when they may be purchased by the Federal Reserve Banks. The basic requirements of eligibility are:

1. The acceptance must arise from an actual commercial transaction, domestic or foreign.
2. It must be unconditional; that is, an unconditional bill, unconditionally accepted.
3. It must be for a definite amount of money.
4. It must possess a definite maturity.

These requirements are set forth specifically in the Federal Reserve Board regulations, with their definitions of Acceptances.

FEDERAL RESERVE REGULATIONS

General Character of Eligible Acceptances

The Federal Reserve Board prescribes* that in general to be eligible for purchase by Federal Reserve Banks, an Acceptance

*Regulation B, series of 1917.

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“Must not have been issued for carrying or trading in stocks, bonds, or other investment securities, except bonds and notes of the Government of the United States.

“Must not be a bill, the proceeds of which have been used or are to be used for permanent or fixed investments of any kind, such as land, buildings, or machinery, or for investments of a merely speculative character.

“Must have been accepted by the drawee prior to purchase by a Federal Reserve Bank.

unless it is accompanied and secured by shipping documents or by a warehouse, terminal, or other similar receipt conveying security title.

“May be secured by the pledge of goods or collateral, provided it is otherwise eligible.”

Eligible Trade Acceptances

A *Trade Acceptance* must conform to the Board's definition of this instrument, and the following more specific requirements must also be met; it

“Must have arisen out of an actual commercial transaction, domestic or foreign; that is, it—

Must be a bill which has been issued or drawn for agricultural, industrial, or commercial purposes or the proceeds of which have been used, or are to be used for the purpose of producing, purchasing, carrying, or marketing goods in one or more of the steps of the process of production, manufacture, or distribution.

“It must have a maturity at time of purchase of not more than ninety days, exclusive of days of grace.”

Evidence of Eligibility.

“A Federal Reserve Bank shall take such steps as it deems necessary to satisfy itself as to the eligibility of the bill offered for purchase, unless it presents *prima facie* evidence thereof

FOREIGN TRADE BANKING CORPORATION

"Or bears a stamp or certificate affixed by the acceptor or drawer showing that it is a Trade Acceptance."

(This usually reads: "The obligation of the acceptor hereof arises out of the purchase of goods from the drawer.")

The Trade Acceptance must be endorsed by a member bank,

Or a satisfactory statement of the financial condition of one or more of the parties to the transaction must be furnished.

Eligible Bankers' Acceptances

A *Bankers' Acceptance*, to be eligible, must be such as described in the Board's definition, and must meet the following requirements, additional to those holding for acceptances in general; it

"Must have a maturity at time of purchase of not more than three months, exclusive of days of grace,

"Must have been drawn under a credit opened for the purpose of conducting, or settling accounts resulting from, a transaction or transactions involving—

(1) "The shipment of goods between the United States and any foreign country, or between the United States and any of its dependencies or insular possessions, or between foreign countries, or

(2) "The shipment of goods within the United States, provided the bill at the time of its acceptance is accompanied by shipping documents, or

(3) "The storage within the United States of readily marketable goods, provided the acceptor of the bill is secured by warehouse, terminal, or other similar receipt, or

(4) "The storage within the United States of goods which have been actually sold, provided the acceptor of the bill is secured by the pledge of such goods.

"Or it must be a bill drawn by a bank or banker in a foreign country or dependency or insular possession of the United States for the purpose of furnishing dollar exchange.

"In this latter case the bank or banker drawing the bill must be in a country, dependency, or possession whose usages of trade have been determined by the Federal Reserve Board to require the drawing of bills of this character."

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Evidence of Eligibility.

A Federal Reserve Bank must be satisfied either by reference to the Acceptance itself or otherwise, that it is eligible for purchase.

"Satisfactory evidence of eligibility may consist of a stamp or certificate affixed by the acceptor, in form satisfactory to the Federal Reserve Bank.

"No evidence of eligibility is required with respect to a bill accepted by a national bank.

"Bankers' Acceptances, other than those accepted or endorsed by Member Banks, shall be eligible for purchase only after the acceptor has furnished a satisfactory statement of financial condition in form to be approved by the Federal Reserve Board, and

"Has agreed in writing with a Federal Reserve Bank to inform it upon request concerning the transactions underlying such acceptances."

Benefits Conferred by Eligibility

Marketability Assured

The eligibility regulations of the Federal Reserve Board aim at maintaining the character of the Acceptance as a fully and freely negotiable credit instrument. They thereby serve to protect the purchaser of the paper.

"Eligibility" provides protection for the purchaser of the Acceptance, which is confined not alone to his knowledge of the names attached to the paper but is assured by the fact, as shown on its face, that, having conformed to the Board's requirements, the Acceptance can be readily rediscounted at Federal Reserve Banks.

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Self-Liquidating Character Made Certain

The conditions demanded by eligibility are such as to make the Acceptance essentially self-liquidating. The merchandise transaction involved virtually finances itself.

Federal Reserve Board's Encouragement

to Use of Acceptances

The Federal Reserve Board has steadily encouraged development of the Acceptance. It has by its rules and regulations created conditions giving special advantages to the Acceptance as a negotiable instrument of credit.

The Board has established a preferential rate in its favor.

It has enlarged the facilities for rediscount.

It has given practical freedom from the limitation placed upon banks to loan to one person or concern upon single-name paper to the extent only of 10 per cent of the bank's capital and surplus.

It has thus broadened banking facilities. The borrower's discounting ability is made practically unlimited so far as he can produce satisfactory Trade Acceptances of his customers.

Advantages of the Trade Acceptance Method

The banker, manufacturer and merchant, and the commercial and financial structure of the country as a whole are benefited through the broad adoption of the Acceptance—the premier self-liquidating, two-name paper—in the conduct of domestic and foreign trade.

Advantages to the Banker

The Trade Acceptance method is of advantage to the banker in that:

It lessens his lending hazard

By substituting two-name paper for unsecured single-name paper.

By assisting him to measure his risks more accurately, showing the true credit standing of both seller and buyer of goods.

By dividing risks, giving him an opportunity to take paper of comparatively small denominations signed by many different acceptors.

FOREIGN TRADE BANKING CORPORATION

It promises a freer and steadier use of discounting facilities.

It increases borrowing possibilities, strengthening the bank's customers' credit.

It increases availability of assets.

Negotiability of the eligible Trade Acceptance is assured by the readiness with which it can be rediscounted at the Federal Reserve Bank.

It provides a high-class secondary reserve.

Advantages to the Seller

Employment of the Trade Acceptance is of advantage to the seller of goods, because resulting economies and fuller utilization of capital place him in a better competitive position.

It enables the seller to eliminate abuse of credit by the buyer.

Transactions are concluded promptly and definitely, doing away with evils such as unearned discount, unwarrantable extensions, etc.

It puts on the buyer responsibility of proving correctness of the transaction.

The buyer by accepting supplies an acknowledgment that he finds the account in order.

Possibilities of dispute and litigation are minimized.

It lessens expense of collections.

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If the Acceptance is made payable at the seller's bank, collection requires no effort on the seller's part. It becomes a detail of banking machinery.

It reduces losses on bad accounts.

The Acceptance acts as a check on customers' tendency to overbuy.

It helps the seller economically to extend the accommodation,

Practically without impairment of his capital, because employment of the Acceptance, by virtue of its eligible quality, enables each transaction substantially to finance itself.

It does away with "dead" capital.

The seller's capital is not tied up in "frozen" accounts. It is relieved from unremunerative financing of customers.

It is transformed into two-name, self-liquidating commercial paper readily convertible into cash at low discount rates, whereas book accounts must usually be sold at a high rate.

It thus lessens need for working capital.

And consequently the ratio of earnings to capital actually employed is increased.

It provides a reliable secondary cash reserve.

The seller thus having his capital in proper liquid form is fortified to meet unexpected business depression.

It enables the seller to conduct his business more systematically.

Because of certainty of regular influx of money and assured borrowing power.

Places him in better shape to keep track of his outstanding obligations.

Advantages to the Buyer

The Trade Acceptance benefits the buyer of goods because

It benefits his business reputation, strengthening his credit with sellers, indicating

That he does not overbuy.

That he is prepared to meet obligations promptly at maturity.

That he is entitled to consideration as a preferred buyer.

It enhances value of his paper when he borrows.

When negotiated, it will benefit by the best preferential discount rates, because of his proved willingness to make prompt payment in assuming the obligation of acceptances.

It frees his transactions with the seller from dependence on special favors.

It makes for systematic, efficient routine in his business, eliminating waste effort.

It automatically prevents accumulation of overdue accounts.

It puts a check on overextension in buying.

General Advantages

Compared with the open book account, cash discount and single-name paper methods of conducting business transactions, the use of the Trade Acceptance is more sound and economical, because it is founded on a logical basis.

AMERICA'S PIONEER DISCOUNT BANK

The Trade Acceptance bears evidence on its face of the rational relationship of buyer, seller and lender, and of its security.

The Trade Acceptance improves trade relations between buyer and seller by clearly defining their respective obligations.

It enables invested capital to do more than its present volume of work with less risk.

It lowers borrowing rates because of the production of standard paper, elimination of unnecessary risk and because the Federal Reserve Board gives to it preferential rediscount rates.

It plays an important part in providing national financial commercial preparedness.

"In the entire list of methods and expedients commonly employed in the class of business which is conducted upon a credit basis, I know of none more safely founded, more logically arranged, more economical in operation or better calculated to protect the proper interests of all parties concerned than the Trade Acceptance."

Lewis E. Pierson.

The Acceptance a Promotor of Foreign Trade

The value of the Acceptance in foreign business is well recognized. The regulation of the Federal Reserve Board, providing for Acceptances to furnish dollar credits, has heightened its advantage to the American exporter and importer.

Its use in foreign trade meets the difficulties of manufacturers in the United States who have been hampered by inability to grant credits as liberally as their foreign competitors. It practically solves the long-credit problem.

Through the use of Acceptances, the exporter avoids the necessity of locking up his capital.

He obtains immediate reimbursement for the value of his shipment by negotiating the draft. He is thus enabled promptly again to use the money for a new transaction.

Acceptances arising from foreign trade have given rise to a vast amount of financing formerly carried on chiefly through London but growing rapidly in New York.

Supplying a Growing Need

London has benefited by the operation of discount banks especially devoted to this form of business. In America, the Foreign Trade Banking Corporation, as a pioneer in the field, seeks to supply a similar need.

Service for the purpose of building up and holding our foreign patronage, is at present much under discussion. While educational work relative to proper packing and similar features is important, these after all are questions of detail.

Of the greatest importance to help us achieve this most desirable result is the matter of credits. A more elastic credit system, in which the Acceptance and the discount bank are vital elements, together with adequate shipping facilities, is what this country chiefly needs to maintain its recently won supremacy as an exporter.

An American Discount Market

Opportunity for the establishment of an American discount market has been opened by the provisions of the Federal Reserve Act and its amendments.

The Acceptance is acknowledged to be "the standard form of paper in the world discount market." Its enjoyment of the purchase and rediscount privileges by Federal Reserve Banks under the rules of eligibility is an important factor in the development of a broad discount market here.

The regulation permitting purchase by the Federal Reserve Banks of Acceptances drawn for the purpose of furnishing dollar exchange has been an incentive to a wider use of this kind of credits in foreign trade transactions, with accompanying demands for larger market facilities for Acceptances.

Improvement in the machinery of financing foreign trade in this respect is the more desirable as the war promises to usher in a period of exacting international commercial competition.

In this situation is marked out the place for a bank that devotes its energies particularly to the business of discounting Trade and Bankers' Acceptances.

Foreign Trade Banking Corporation

Incorporated under the Banking
Laws of the State of New York

35 Wall Street New York

Capital and Surplus - \$2,200,000

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George A. Gaston - - - - - President
Max May - Vice-President & Managing Director
William T. Law - - - - - Secretary

DIRECTORS

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Harry T. Hall - Vice-President, *Merchants National Bank*
Max May - Vice-President and Managing Director
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